Privy Council Appeal No. 41 of 1991

Workers Trust & Merchant Bank Limited *Appellant*

v.

Dojap Investments Limited *Respondent*

(and Cross-appeal)

FROM

THE COURT OF APPEAL OF JAMAICA

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 22ND FEBRUARY 1993

Present at the hearing:-

LORD KEITH OF KINKEL
LORD JAUNCEY OF TULLICHETTLE
LORD DONALDSON OF LYMINGTON
LORD BROWNE-WILKINSON
SIR CHRISTOPHER SLADE

*[Delivered by **Lord Browne-Wilkinson**]*

This case raises the question whether a deposit in excess of 10% paid under a contract for the sale of land can be lawfully forfeited by the vendor in the event of a failure by the purchaser to complete on the due date.

On 5th October 1989 Workers Trust & Merchant Bank Limited ("the Bank") as second mortgagee sold certain premises at auction to Dojap Investments Limited ("Dojap") at a price of Jamaican $11,500,000. Clause 4 of the contract provided for the payment of a deposit of 25% of the contract price and a deposit of $2,875,000 was duly paid by Dojap to the Bank's solicitors. The contract provided that the remainder of the purchase money should be paid within 14 days of the date of the auction whereupon the Bank were to execute a transfer of the property to Dojap and lodge such transfer for registration. Clause 15 of the contract provided that time should be of the essence of all time limits contained in the contract. Clause 13 of the contract provided as follows:-

> "13. If the purchaser shall fail to observe or comply with any of the foregoing stipulation on his part his deposit shall be forfeited to the vendor who shall be at liberty (without tendering any transfer) to re-sell the property either by public auction or private contract at

> such time and in such manner and subject to such conditions as the vendor may think fit and any deficiency in price which may result on and all charges costs and expenses attending a re-sale or attempted re-sale, together or rendered useless by such default, shall be made good and paid by the defaulting purchaser at the present sale and be recoverable from him by the vendor as liquidated damages. Any increase of price on a re-sale shall belong to the vendor."

On the date fixed for completion (19th October 1989) Dojap's attorney, Mr. Clough, sent to the Bank a letter of undertaking from the Jamaica Citizens Bank Limited to pay the balance of the purchase price, subject to certain conditions. The Bank's attorney, Miss Eaton, rejected this and gave Dojap 24 hours to provide a satisfactory undertaking. Dojap attempted to do so on 20th October 1989, but the Bank again rejected it. On 23rd October, the Bank wrote to Dojap rescinding the contract and purporting to forfeit the deposit. Dojap refused to accept this, and on 26th October 1989 tendered to the Bank the balance of the purchase price with interest. The Bank returned the cheque the next day.

On 24th November 1989 Dojap started proceedings claiming specific performance or alternatively relief from forfeiture of the deposit. The case was heard by Zacca C.J. before whom a number of different issues arose for decision on the claim for specific performance. These are no longer in issue before the Board. The judge gave judgment on 25th June 1990, rejecting Dojap's claim for specific performance and its claim for return of the deposit.

On 12th November 1990 Dojap arranged to purchase the same piece of land from the first mortgagee, Jamaica Citizens Bank Limited, as a result of which the claim to specific performance of the contract of the Bank became largely academic. Dojap appealed to the Court of Appeal but did not pursue its claim for specific performance. On Dojap's alternative claim for relief from forfeiture and the return of the deposit, the Court of Appeal (Rowe P., Forte J.A. and Downer J.A.) held that Dojap was entitled to relief from forfeiture to the extent that the deposit exceeded 10% of the price but did not award any interest on that sum. The Bank appeals to the Board against the decision of the Court of Appeal to give such relief against forfeiture. Dojap cross-appeals claiming that it should have been awarded relief against forfeiture as to the whole of the 25% deposit and should also have been awarded interest.

In general, a contractual provision which requires one party in the event of his breach of the contract to pay or forfeit a sum of money to the other party is unlawful as being a penalty, unless such provision can be justified as being a payment of liquidated damages being a genuine pre-estimate of the loss which the innocent party will incur by reason of the breach. One exception to this general rule is the provision for the payment of a deposit by the purchaser

on a contract for the sale of land. Ancient law has established that the forfeiture of such a deposit (customarily 10% of the contract price) does not fall within the general rule and can be validly forfeited even though the amount of the deposit bears no reference to the anticipated loss to the vendor flowing from the breach of contract.

This exception is anomalous and at least one textbook writer has been surprised that the courts of equity ever countenanced it: see *Farrand, Contract and Conveyancing* 4th Edition page 204. The special treatment afforded to such a deposit derives from the ancient custom of providing an earnest for the performance of a contract in the form of giving either some physical token of earnest (such as a ring) or earnest money. The history of the law of deposits can be traced to the Roman law of arra, and possibly further back still: see *Howe v. Smith* (1884) 27 Ch.D. 89 per Fry L.J. at pages 101-2. Ever since the decision in *Howe v. Smith*, the nature of such a deposit has been settled in English law. Even in the absence of express contractual provision, it is an earnest for the performance of the contract: in the event of completion of the contract the deposit is applicable towards payment of the purchase price; in the event of the purchaser's failure to complete in accordance with the terms of the contract, the deposit is forfeit, equity having no power to relieve against such forfeiture.

However, the special treatment afforded to deposits is plainly capable of being abused if the parties to a contract, by attaching the label "deposit" to any penalty, could escape the general rule which renders penalties unenforceable. There are two authorities which indicate that this cannot be done. In *Stockloser v. Johnson* [1954] 1 Q.B. 476, Denning L.J. in considering the power of the court to relieve against forfeiture said, obiter, at page 491:-

> "Again, suppose that a vendor of property, in lieu of the usual 10% deposit, stipulates for an initial payment of 50% of the price as a deposit and part payment; and later, when the purchaser fails to complete, the vendor resells the property at a profit and in addition claims to forfeit the 50% deposit. Surely the court will relieve against the forfeiture. The vendor cannot forestall this equity by describing an extravagant sum as a deposit, any more than he can recover a penalty by calling it liquidated damages."

In *Linggi Plantations Limited v. Jagatheesan* (1972) 1 M.L.J. 89 Lord Hailsham delivered the judgment of the Board which upheld the claim to forfeit a normal 10% deposit even though the vendor had in fact suffered no loss. He referred on a number of occasions to a requirement that the amount of a deposit should be "reasonable" and said this at page 94:-

> "It is also no doubt possible that in a particular contract the parties may use language normally appropriate to deposits properly so called and even to forfeiture which turn out on investigation to be purely colourable and that in such a case the real nature of the transaction might turn out to be the imposition of a penalty, by purporting to render forfeit something which is in truth part payment. This no doubt explains why in some cases the irrecoverable nature of a deposit is qualified by the insertion of the adjective 'reasonable' before the noun. But the truth is that a reasonable deposit has always been regarded as a guarantee of performance as well as a payment on account, and its forfeiture has never been regarded as a penalty in English law or common English usage."

In the view of their Lordships these passages accurately reflect the law. It is not possible for the parties to attach the incidents of a deposit to the payment of a sum of money unless such sum is reasonable as earnest money. The question therefore is whether or not the deposit of 25% in this case was reasonable as being in line with the traditional concept of earnest money or was in truth a penalty intended to act *in terrorem*.

The Chief Justice tested the question of "reasonableness" by reference to the evidence before him that it was of common occurrence for banks in Jamaica selling property at auction to demand deposits of between 15% and 50%. He held that, since this was a common practice, it was reasonable. Like the Court of Appeal, their Lordships are unable to accept this reasoning. In order to be reasonable a true deposit must be objectively operating as "earnest money" and not as a penalty. To allow the test of reasonableness to depend upon the practice of one class of vendor, which exercises considerable financial muscle, would be to allow them to evade the law against penalties by adopting practices of their own.

However although their Lordships are satisfied that the practice of a limited class of vendors cannot determine the reasonableness of a deposit, it is more difficult to define what the test should be. Since a true deposit may take effect as a penalty, albeit one permitted by law, it is hard to draw a line between a reasonable, permissible amount of penalty and an unreasonable, impermissible penalty. In their Lordships' view the correct approach is to start from the position that, without logic but by long continued usage both in the United Kingdom and formerly in Jamaica, the customary deposit has been 10%. A vendor who seeks to obtain a larger amount by way of forfeitable deposit must show special circumstances which justify such a deposit.

As their Lordships understood from the submissions made in argument, formerly the normal practice in Jamaica was to require a deposit of 10%. This was changed by the introduction of a transfer tax by the Transfer Tax Act, 1971. Under that Act, a transfer tax of 7.5% is payable on

a transfer of land on sale. Although the tax is ultimately payable by the transferor (section 3), under section 18 it is collected from the transferee, i.e. the purchaser. As from 3rd April 1984, any contract for the sale of land must contain a requirement for the payment of a deposit of at least 7.5% and the purchaser is required to pay this sum to the Commissioner of Stamp Duty and Transfer Tax: section 18(4). The purchaser is entitled to recover from the vendor the amount of the tax so paid either by way of deduction from the purchase price or by action: section 18(1).

Their Lordships were told that in practice this statutory machinery is not followed. Since the tax has to be paid within 30 days of the date of contract (failing which interest is payable by the vendor), a vendor is concerned to see that the tax is paid promptly. Accordingly what happens in practice is that the contractual deposit is increased to at least 17.5% and is paid by the purchaser to the vendor. The vendor then pays the tax. It is apparently this practice that has caused the departure from the previously customary deposit of 10%.

If the contract of sale in respect of which the transfer tax is payable is not in fact completed, there is no liability to pay the tax: if such tax has been paid and the contract goes off, the tax can be recovered by the vendor and, by virtue of section 16(1), any amount so refunded "shall be dealt with according to the rights of the parties to the contract (including any requirement of a deposit implied therein under sub-section (4) of section 18)".

Since in the present case completion was supposed to take place within 14 days of the contract, in the ordinary course completion would have taken place before the transfer tax was due. Accordingly, there was strictly no need in the present case for the Bank to insist on the inclusion in the deposit of a sum equal to 7.5% of the contract price so as to be in pocket to pay the tax when it fell due. However the provisions as to the transfer tax are relevant. First, the transfer tax provides the explanation for the departure from the customary 10% deposit which was previously contracted for in Jamaica. Second, it illustrates how unconscionable it would be for the vendor to forfeit the deposit to the extent of 7.5% in the ordinary case. Where the tax has in fact been paid by the vendor out of the deposit and then the sale goes off, the vendor would recover the tax from the Revenue and then put the money in his own pocket.

In the present case, the attorney for the Bank in evidence sought to justify the amount of the 25% deposit in part by reference to the amount of the transfer tax which would have been payable viz. $862,500. This evidence indicates that far from the amount of the deposit having been fixed upon as a reasonable amount of earnest,

the amount was substantially influenced by fiscal considerations having nothing to do with encouragement to perform the contract.

For the rest, although the attorney for the Bank gave evidence that the amount of the deposit was fixed in part because it was a sum set "to ensure that persons do not bid frivolously at the auction" she also sought to justify the amount of the deposit by reference to the payments that would have had to be made on completion i.e. tax, stamp duty, auction costs and auctioneer's commission. She accepted that the amount of the deposit was far in excess of what would have been required to cover the maximum out of pocket expenses which would have attended completion.

Their Lordships agree with the Court of Appeal that this evidence falls far short of showing that it was reasonable to stipulate for a forfeitable deposit of 25% of the purchase price or indeed any deposit in excess of 10%. As for the tax element, the Board do not suggest that it would be unreasonable for a vendor to require advance payment of an amount sufficient to discharge the liability for transfer tax on or before completion. But it does not follow that such advance payment of tax should be capable of forfeiture if completion does not take place: such tax is either not in the event payable or is recoverable by the vendor. However, quite apart from the specific tax element in this case, there is in the view of the Board no sufficient evidence to justify a deposit of 25% as being a true deposit.

The question therefore arises whether the court has jurisdiction to relieve against the express provision of the contract that the deposit of 25% was to be forfeited. Although there is no doubt that the court will not order the payment of a sum contracted for (but not yet paid) if satisfied that such sum is in reality a penalty, it was submitted that the court could not order, by way of relief, the repayment of sums already paid to the defendant in accordance with the terms of the contract which, on breach, the contract provided should be forfeit. The basis of this submission was the view expressed in a considered obiter dictum of Romer L.J. in *Stockloser v. Johnson (supra)*.

In that case there was a contract for the sale of quarry machinery to the plaintiff, the purchase price to be paid by instalments. The contract provided that in the event of a default in payment of the instalments, the vendor could re-take the machinery and all instalments of the price previously paid should be forfeit. Pursuant to the contract, the plaintiff took possession and used the machinery but defaulted in payment of an instalment. The defendant forfeited the instalments already paid. In the action, the plaintiff sought to recover the instalments, alleging that their forfeiture was a penalty. The Court of Appeal unanimously held that the forfeiture did not constitute a penalty on the facts of that case but went on to express conflicting views, obiter, as to whether, if the forfeiture had been a penalty, the court had jurisdiction to

order repayment. Somervell L.J. and Denning L.J. expressed the view that there was such jurisdiction. Romer L.J. held that there was no general right in equity to mend the parties' bargain and that, even where there was jurisdiction to relieve from forfeiture, that could only be exercised by allowing a late completion to a party who was in default in performance but willing and able to carry out the terms of the contract belatedly.

Their Lordships do not find it necessary to decide which of those two views is correct in a case where a party is seeking relief from forfeiture for breach of contract to pay a price by instalments, the party in default having been let into possession in the meantime. This is not such a case. In the view of their Lordships, since the 25% deposit was not a true deposit by way of earnest, the provision for its forfeiture was a plain penalty. There is clear authority that in a case of a sum paid by one party to another under the contract as security for the performance of that contract, a provision for its forfeiture in the event of non-performance is a penalty from which the court will give relief by ordering repayment of the sum so paid, less any damage actually proved to have been suffered as a result of non-completion: *Commissioner of Public Works v. Hills* [1906] A.C. 368. Accordingly, there is jurisdiction in the court to order repayment of the 25% deposit.

The Court of Appeal took a middle course by ordering the repayment of 15% out of the 25% deposit, leaving the Bank with its normal 10% deposit which it was entitled to forfeit. Their Lordships are unable to agree that this is the correct order. The Bank has contracted for a deposit consisting of one globular sum, being 25% of the purchase price. If a deposit of 25% constitutes an unreasonable sum and is not therefore a true deposit, it must be repaid as a whole. The Bank has never stipulated for a reasonable deposit of 10%: therefore it has no right to such a limited payment. If it cannot establish that the whole sum was truly a deposit, it has not contracted for a true deposit at all.

As to interest, Downer J.A. in the Court of Appeal was under the misapprehension that Dojap had never made any claim for interest: he indicated that if they had done so he would have awarded 12% interest (being the rate provided in clause 5 of the contract). It is clear that in written submissions headed "Reply to defendant's submissions" counsel for Dojap before the Court of Appeal did claim such interest. Dojap is therefore entitled to interest at 12% per annum from the date of rescission until the date of actual payment.

Finally, it appears that the Bank may have suffered some damage as a result of Dojap's failure to complete. If so, the Bank is entitled to deduct the amount of such damages from the "deposit" of 25%. Such damage has not been quantified in the judgment below but appears to be

small in amount. It would not be right to keep Dojap out of all its money to await the outcome of the necessary enquiry as to damages. The Bank ought accordingly to make immediate repayment of a substantial amount of the deposit, leaving a fund out of which the Bank's damages, if any, can be satisfied.

Their Lordships will therefore humbly advise Her Majesty that the appeal ought to be dismissed and the cross-appeal allowed, and that the order of the Court of Appeal should be varied so as to provide:

(1) an enquiry as to the damage (if any) suffered by the Bank by reason of Dojap's failure to complete the contract;

(2) an order that the Bank forthwith repay to Dojap the sum of $2,000,000 (being part of the deposit) together with interest at 12% per annum from 23rd October 1989 (being the date of rescission) down to the date of actual payment;

(3) that the sum, if any, found due under the enquiry as to damages be deducted from the remainder of the deposit ($875,000) and that the balance of the said sum of $875,000 be paid to Dojap together with interest as aforesaid; and

(4) an order that the Bank must pay Dojap's costs of the appeal to the Court of Appeal.

The Bank must pay Dojap's costs before their Lordships' Board.